

AMNESTY CLEAN-UP PROPOSALS

- 1. Eliminate The Amnesty Penalty On Any Post-Amnesty Deficiencies**
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1. Eliminate The Amnesty Penalty On Any Post-Amnesty Deficiencies

- **Problem:** Any assessments that become final or any amounts that are self-assessed for amnesty-eligible years after the end of amnesty are subject to the post-amnesty penalty. Cal-Tax contends that if the purpose of the amnesty penalty is to encourage taxpayers who have underreported their tax liability to file for amnesty, it should not apply to a taxpayer that discovers or is assessed an additional tax liability after amnesty is over and so arguably could not have participated in the amnesty program.
- **Proposed Solution from Cal-Tax:** Eliminate the post-amnesty penalty, including in the following situations:
 - Assessments on amnesty-eligible years that become final after the end of the amnesty.
 - Self-assessed amounts, such as balances due on amended returns, for amnesty-eligible years made after the end of the amnesty period.
- **Justification:** The post-amnesty penalty is arguably harsh, particularly for individuals and small businesses without professional representation that may not be aware of as yet unidentified liabilities. Since it would eliminate the penalty completely, this proposal would also resolve the following issues:
 - Retroactive post-amnesty law change, i.e., the “Amdahl” issue.
 - Due and payable (Proposal #2).
 - Netting (Proposal #3).
- **Revenue:** This proposal is estimated to result in a combined revenue loss of \$105 million for fiscal years 2004/05 and 2005/06.

2. Clarification of “Due and Payable”

- **Problem:** For amounts that become final after the last day of amnesty, the amnesty penalty will be calculated as an amount equal to 50% of the interest computed on the final amount unpaid as of March 31, 2005, from the original due date of the return for that tax year to March 31, 2005. Use of the term “due and payable” in Revenue and Taxation Code section 19777.5 is the basis for differing arguments of when the amnesty penalty applies and the extent to which timing of payments can reduce the penalty amount.
- **Proposed Solution from Spidell and Cal-Tax:** Define “due and payable” consistent with section 19049 that generally states that a deficiency becomes “due and payable” 15 days from the date a notice and demand of final assessment is mailed to a taxpayer.
- **Justification:** Section 19049 states that an assessment is not “due and payable” until 15 days following notice and demand of final assessment. Under this definition, a taxpayer could make payments after amnesty, but before 15 days following notice and demand of final assessment, for purposes of computing the post-amnesty penalty.
- **Revenue:** This proposal is estimated to result in a combined revenue loss of \$85 million for fiscal years 2004/05 and 2005/06.

3. Netting

- **Problem:** The amnesty penalty applies to amounts already due on the last day of amnesty and amounts that become due after amnesty. Existing law requires the amnesty penalty to be computed for each year separately; overpayments for one year may not be applied (“netted”) against underpayments for an amnesty year to reduce the penalty.

- **Proposed Solution:**

- Option 1

- Permit netting in the following specific scenarios:

- A final federal determination is made for multiple years after amnesty, resulting, for state purposes, in an overpayment for one or more years and an underpayment for one or more amnesty years.
 - An FTB audit is started before and completed after amnesty ends resulting in an overpayment for one or more years and an underpayment for one or more amnesty years.
 - An audit started after amnesty transfers the recognition of an item of income or a deduction from one year to another, resulting in an overpayment for one or more years and an underpayment for one or more amnesty years.

- Option 2

- Permit netting of amounts among different years in any situation where a multi-year audit results in both an overpayment for one or more years and an underpayment for amnesty-eligible years. This option offers a broader solution that would allow for netting in a post-amnesty FTB audit of multiple years resulting in both overpayments and underpayments, in addition to the scenarios listed in Option 1.

- **Justification:** The purpose of the amnesty penalty is to encourage self-assessment of unpaid or underpaid tax liabilities for amnesty-eligible years. Applying the post-amnesty penalty to an underpayment year without taking into account a related overpayment year arguably compromises the purpose of amnesty.

- **Revenue:**

- Option 1: This proposal is estimated to result in a combined revenue loss of \$8 million for fiscal years 2004/05 and 2005/06.
 - Option 2: This proposal is estimated to result in a combined revenue loss of \$10 million for fiscal years 2004/05 and 2005/06.

4. Establish A Statute Of Limitations On Collections

- **Problem:** Current state law lacks a statute of limitations for the collection of delinquent taxpayer accounts by the department; therefore, taxpayer balances are carried on the department's books indefinitely as a receivable. This receivable balance is a misleading portrayal of the amounts collectable by the department.

The recent Amnesty Program sent out 1.7 million letters to taxpayers urging them to apply for amnesty. Many of these letters were mailed to taxpayers with very old balances due, which brought up the issue of whether state law should have a statute of limitations for collecting taxpayer accounts.

- **Proposed Solution:** Create a statute of limitations on collections that sets the period during which tax may be collected to the period that expires 20 years from the bill date for collections.
- **Justification:** The proposed 20-year statute of limitations would result in a more accurate representation of the department's receivables. Providing a statute of limitations would also move California toward current federal law, which provides for a 10-year statute of limitations.
- **Revenue:** If California sets the statute of limitations on collections to 20 years from the date a bill is sent to the taxpayer, the revenue loss would be approximately \$2 million annually.

The revenue loss would be \$15 million annually with a 10-year statute of limitations and \$5 million annually with a 15-year statute of limitations.

5. Discretion to Extinguish Certain Taxpayer Debts

- **Problem:** Under current state law, the department has the authority to place taxpayer debts that meet certain criteria into inactive status. An inactive debt remains on the collection system as due and payable, but no further collection action is taken unless new asset information is received. To be declared inactive, a debt must be deemed uncollectible or the amount of the debt is such that it does not justify the cost of its collection. Under amnesty, taxpayers that do not participate, but have an outstanding debt, will receive the amnesty penalty. For inactive debts, imposing the amnesty penalty serves no purpose since the account has been deemed uncollectible.

In addition, allowing the inactive debts to remain on the system inflates the department's accounts receivable numbers and provides a false reflection of actual revenues that will ultimately be realized.

- **Proposed Solution:** Allow the department to extinguish inactive taxpayer accounts with a debt of less than \$250, or regardless of amount if any of the following criteria are met:
 - Decedent cases where the liability is four years or older with no liable spouse and no probate.
 - Accounts with permanent financial hardship as determined by the department.
 - Accounts deemed uncollectible and older than 30 years.
- **Justification:** Allowing the department to extinguish certain inactive accounts would prevent the imposition of the amnesty penalty on long inactive, uncollectible accounts. In addition, the accounts receivable system would more accurately reflect the amount of potential receivables.
- **Revenue:** Minor.

6. Continuing Compliance Requirement

- **Problem:** One of the conditions for participating in amnesty is that a taxpayer must agree to file all required returns and pay any tax due for the 2005 and 2006 taxable years. If a taxpayer fails to pay taxes due for those years and that failure results in the imposition of a collection cost recovery fee, then all penalties, fees, and associated interest previously waived under amnesty immediately become due and payable. This includes failure to pay subsequent assessments for taxable years 2005 and 2006, which might occur many years later. Retroactively reassessing penalties and fees could penalize unwary or unfortunate taxpayers. For example, if a taxpayer that participated in amnesty became unable to pay the tax liability for the 2006 taxable year, all penalties, fees, and interest waived during amnesty would be added to that taxpayer's account.
- **Proposed Solution:** Repeal the provision that would retroactively impose all previously waived penalties, fees, and associated interest should a taxpayer fail to comply with the requirement to pay all taxes owed for the 2005 and 2006 taxable years.
- **Justification:** This proposal would prevent taxpayers that complied with the terms of amnesty from being unfairly subject to the retroactive imposition of previously waived penalties, fees, and interest for future compliance failures for different years.
- **Revenue:** Loss of \$5 million.

7. Technical Clarification Of Certain Amnesty Provisions

- **Problems:** Several amnesty provisions lack technical clarity.
 - 1) The language of section 19733 implies in one phrase that actions that must occur during amnesty, such as filing all tax returns and paying all taxes and interest due, must occur during the two-month amnesty period, which under section 19731 runs from February 1, 2005, to March 31, 2005. Those actions can in fact be completed at any time prior to May 31, 2005, which is made clear within another paragraph of the same statute.
 - 2) Section 19738 states that a taxpayer with an installment agreement entered into prior to amnesty, that chose not to come in under amnesty, is not subject to the amnesty penalty. However, the provision was not intended to provide a blanket exemption from the amnesty penalty for other tax liabilities not covered by the installment agreement. Consequently, it is unclear whether amounts later assessed for the same year or amounts due for other years would still be subject to the amnesty penalty.
- **Proposed Solutions:**
 - 1) Amend section 19733 to clarify which required actions must occur no later than March 31, 2005, and which actions must occur no later than May 31, 2005.
 - 2) Amend section 19738 to clarify that only those amounts covered by a current installment agreement will be exempt from the amnesty penalty, and any amounts later assessed for the same year or amounts due for other years not under the installment agreement would be subject to the amnesty penalty.
- **Justification:** This proposal would remove ambiguity from the law and eliminate possible disputes between taxpayers and the department.
- **Revenue:** None.